



IN THE
Supreme Court of the United States
October Term, 1975

No. **75-1853**

BOISE CASCADE CORPORATION AND SUBSIDIARY COMPANIES,
Petitioner,

v.

- THE UNITED STATES

**Petition for a Writ of Certiorari to the
United States Court of Claims**

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June 1976

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**Petition for a Writ of Certiorari to the
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Boise Cascade Corporation and Subsidiary Companies,
by their attorneys, petitions for a writ of certiorari to
review the judgment of the United States Court of Claims.

Opinions Below

The findings of fact and opinion of the Trial Judge of the United States Court of Claims (which insofar as relevant to the issue with respect to which a writ of certiorari is sought are reprinted in Appendix A, *infra*, pp. A-1 through A-21) are not officially reported. The opinion of the Court of Claims (which insofar as relevant to the issue with respect to which a writ of certiorari is sought) is reprinted in Appendix B, *infra*, pp. B-1 through B-3. The order of the Court of Claims amending the opinion is reprinted in Appendix C, *infra*, p. C-1. The opinion of the Court of Claims in *General Foods Corporation v. United States*,

Court of Claims no. 70-73 (Appendix D, *infra*, pp. D-1 through D-14) is not officially reported, and a copy is attached in view of the Court of Claims' reliance on this decision in their opinion in the instant case.

Jurisdiction

The judgment of the Court of Claims (Appendix B, *infra*, p. B-3) was entered on January 28, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

Question Presented

Whether gains attributable to original issue discount on evidences of indebtedness, issued by corporations after December 31, 1954 and before May 28, 1969, and held by plaintiffs for periods of not more than six months are taxable as short-term capital gains in the year such evidences of indebtedness were sold or exchanged.

Statutes Involved

Section 1232, as originally enacted in the Internal Revenue Code of 1954, P.L. 591, 68A Stat. 3 provides in part as follows:

"SEC. 1232. BONDS AND OTHER EVIDENCES OF INDEBTEDNESS.

(a) GENERAL RULE.—For purposes of this subtitle, in the case of bonds, debentures, notes, or certificates or other evidences of indebtedness, which are capital assets in the hands of the taxpayer, and which are issued by any corporation, or government or political subdivision thereof—

(1) RETIREMENT.—Amounts received by the holder on retirement of such bonds or other evi-

dences of indebtedness shall be considered as amounts received in exchange therefor (except that in the case of bonds or other evidences of indebtedness issued before January 1, 1955, this paragraph shall apply only to those issued with interest coupons or in registered form, or to those in such form on March 1, 1954).

"(2) SALE OR EXCHANGE.—

(A) GENERAL RULE.—Except as provided in subparagraph (B), upon sale or exchange of bonds or other evidences of indebtedness issued after December 31, 1954, held by the taxpayer more than 6 months, any gain realized which does not exceed an amount which bears the same ratio to the original issue discount (as defined in subsection (b)) as the number of complete months that the bond or other evidences of indebtedness was held by the taxpayer bears to the number of complete months from the date of original issue to the date of maturity, shall be considered as gain from the sale or exchange of property, which is not a capital asset. Gain in excess of such amount shall be considered gain from the sale or exchange of a capital asset held more than 6 months.

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"(b) DEFINITIONS.—

(1) ORIGINAL ISSUE DISCOUNT.—For purposes of subsection (a), the term 'original issue discount' means the difference between the issue price and the stated redemption price at maturity. If the original issue discount is less than one-fourth of 1 percent of the redemption price at maturity multiplied by the number of complete years to maturity, then the issue discount shall be considered to be zero. For purposes of this paragraph, the term 'stated redemption

price at maturity' means the amount fixed by the last modification of the purchase agreement and include dividends payable at that time."

Section 1232, as amended by the Tax Reform Act of 1969, P. L. 91-172, 83 Stat. 487 provides in pertinent part as follows:

"SEC. 1232. Bonds and Other Evidence of Indebtedness.

• • • • •

"(B) CORPORATE BONDS ISSUED ON OR BEFORE MAY 27, 1969, AND GOVERNMENT BONDS.—Except as provided in subparagraph (C), on the sale or exchange of bonds or other evidences of indebtedness issued by a government or political subdivision thereof after December 31, 1954, or by a corporation after December 31, 1954, and on or before May 27, 1969, held by the taxpayer more than 6 months, any gain realized which does not exceed—

(i) an amount equal to the original issue discount (as defined in subsection (b)), or

(ii) if at the time of original issue there was no intention to call the bond or other evidence of indebtedness before maturity, an amount which bears the same ratio to the original issue discount (as defined in subsection (b)) as the number of complete months that the bond or other evidence of indebtedness was held by the taxpayer bears to the number of complete months from the date of original issue to the date of maturity, shall be considered as gain from the sale or exchange of property which is not a capital asset. Gain in excess of such amount shall be considered gain from the sale or exchange of a capital asset held more than 6 months."

Statement

Petitioner's predecessor by merger purchased noninterest bearing evidences of indebtedness at a discount which were sold or retired in a period of not more than six months. The evidences of indebtedness were held by the taxpayer as an investment. Such evidences of indebtedness were issued by corporations after December 31, 1954 and before May 28, 1969. The applicable statute is section 1232 of the Internal Revenue Code of 1954 as originally enacted, the pertinent provisions of which are quoted above. Effective with respect to evidences of indebtedness issued after May 27, 1969, section 1232 was amended to change the law as to evidences of indebtedness issued by corporations but not as to evidences of indebtedness issued by a government or a political subdivision thereof.

The gains realized by taxpayer on the sale of evidences of indebtedness were attributable to original issue discount. Taxpayer treated such gains as short-term capital gains against which taxpayer offset capital losses or capital loss carryovers.

The Commissioner of Internal Revenue determined that the gains should be treated as ordinary income and accrued ratably as interest is accrued. Deficiencies were assessed and paid and the taxpayer brought suit for refund in the United States Court of Claims. The Trial Judge held for the taxpayer and his decision was reversed by the Court. In reversing on this issue the Court relied on its decision in *General Foods Corporation v. The United States*, both cases being decided on January 28, 1976.

Reasons for Granting the Writ

The Court of Claims has decided a question of major significance to the administration of the Internal Revenue

Code in a manner which conflicts directly with an express statement of the Committee on Finance as to the intention of Congress which statement is exactly on point. The issue before the Court of Claims concerned the intention of Congress in limiting the application of the provisions of section 1232 concerning original issue discount to evidences of indebtedness "held more than 6 months"; see section 1232(a)(2)(A) quoted above.

When Congress adopted section 1232 as part of the Internal Revenue Code of 1954 it did not provide that original issue discount realized by a holder of an evidence of indebtedness should be treated like interest but instead established a statutory system for treatment of realized original issue discount. That such a system was established has been recognized by the Supreme Court of the United States in *Commissioner of Internal Revenue v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134 (1974) in footnote 9 of its opinion (417 U.S. 134, 145).

In the system adopted by Congress, it was provided in section 1232 that gain from the disposal of evidences of indebtedness "held more than 6 months" shall be treated as gain from sale of property that is not a capital asset to the extent that such gain is attributable to original issue discount. The period of six months is normally the dividing line between short-term and long-term capital gain under the Internal Revenue Code.

Although there is no express provision in the statute concerning gain attributable to original issue discount on evidences of indebtedness held for not more than six months, Congress indicated that it was its intention that such gain should be treated as short-term capital gain. When the Internal Revenue Code of 1954 was originally adopted, both the Committee on Ways & Means and the Committee on Finance in their committee reports indicated

that gain on the disposal of evidences of indebtedness would be treated as capital gain except to the extent that ordinary income treatment was expressly provided. These statements manifested the intention of Congress in 1954 that original issue discount on evidences of indebtedness held for not more than six months shall be treated as short-term capital gain. The specific statements were as follows:

"Paragraph (1) restates the content of present law. For bonds or other evidences of indebtedness issued after December 31, 1954, the bill abandons present restriction of capital treatment on retirement to bonds and other evidences of indebtedness which have interest coupons attached or which are in registered form. *Redemption of all bonds and other evidences of indebtedness will receive capital gain or loss treatment on redemption if issued after December 31, 1954, and if they are otherwise capital assets, except to the extent that the recovery of issue discount is subject to paragraph (2)* [section 1232(a)(2)]." (House Report No. 1337, 83d Cong., 2d Sess., p. A275 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4417); Senate Report 1622, 83d Cong., 2d Sess., p. 433 (3 U.S.C. Cong. & Adm. News (1954) 4621, 5076)) [Emphasis supplied.]

When Congress amended the Internal Revenue Code of 1954 in the Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487, the Committee on Finance, reiterating the intention of Congress previously expressed in 1954, stated directly that realized original issue discount on evidences of indebtedness held not more than six months should be treated as short-term capital gain. The statement, which was exactly on point, was as follows:

"The rules provided by the bill regarding the treatment of original issue discount are not to apply in the case of bonds or other evidences of indebted-

ness issued by any government or political subdivision (or in the case of bonds or other evidence of indebtedness issued by a corporation on or before October 9, 1969). In these cases, the rules of present law regarding the treatment of original issue discount on the sale or exchange of a bond which is a capital asset in the hands of the taxpayer and which has been held by the taxpayer for more than 6 months are to continue to apply. *In addition, in these cases, gain on the sale or exchange of a bond or other evidence of indebtedness which is a capital asset in the hands of the taxpayer but which has not been held by the taxpayer for more than 6 months is to be treated as a short-term capital gain as under present law.*" (Senate Report No. 91-552, 91st Cong., 1st Sess., 1969-3 C.B. 423, 518) [Emphasis supplied.]

In its report the Committee on Finance not only indicated its understanding and intention that the bonds "held more than 6 months" in section 1232 had since 1954 required that realized original issue discount on bonds and other evidences of indebtedness issued by both corporations and governments should be taxed as short-term capital gain but it further indicated that this method of taxation should continue to apply to bonds and other evidences of indebtedness issued by a government or political subdivision thereof not only prior to the effective date of the Tax Reform Act of 1969 but also subsequent to that date and up to the present time.

In holding that realized original issue discount on evidences of indebtedness held for not more than six months should be taxed as ordinary income, the Court of Claims reached a decision directly contrary to the expressed intention of Congress concerning a phrase that continues to be part of section 1232 of the Internal Revenue Code of 1954. This decision has created confusion on the part of tax-

payers as to the correct method of reporting gains from original issue discount on evidences of indebtedness issued by government and political subdivisions thereof, whether domestic or foreign, and has provided a precedent that administrators of the Internal Revenue Service may consider to require them to tax such gains in a manner directly contrary to the specifically expressed intention of Congress.

Conclusion

The Petition for Certiorari should be granted.

Respectfully submitted,

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June 1976

APPENDIX A

**In the
UNITED STATES COURT OF CLAIMS
TRIAL DIVISION**

Nos. 321-69 and 81-71

(Filed: Sep 20 1974)

BOISE CASCADE CORPORATION and Subsidiary Companies

v.

THE UNITED STATES

Norton Kern, attorney of record, for plaintiff. *Lawrence C. Wilson, Reid & Priest*, of counsel.

Theodore D. Peyser, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Gilbert E. Andrews*, of counsel.

Opinion*

FLETCHER, *Trial Judge*: These are consolidated cases in which plaintiffs seek the recovery of nearly \$2,400,000 in income taxes, plus interest thereon, paid for the years 1955 through 1961. The questions presented are:

1. In the years 1955 through 1961, plaintiffs purchased at an original issue discount commercial paper issued after

* The trial judge's recommended decision and conclusion of law are submitted in accordance with Rule 134(h).

December 31, 1954, and plaintiffs held the paper for not more than six months.

(a) Is the earned original issue discount taxable as ordinary income or short-term capital gain?

(b) Is the discount on each note taxable as earned, since plaintiffs were accrual-basis taxpayers, or is all of the discount taxable in the year plaintiffs sold or redeemed the note?

2. Did the plaintiffs' accounting method of deferring prepaid income clearly reflect income?

3. Under the circumstances of this case, should the accrual of earned income be deferred because payment thereof is not due until a subsequent tax year?

Summary Statement of the Facts Relating to All Issues

The plaintiffs are Boise Cascade Corporation and several of its subsidiary companies. The original petition was filed by Ebasco Industries Inc. and its subsidiary companies which had filed consolidated tax returns for the taxable years 1955 through 1958. Later, Ebasco Industries was merged with Boise Cascade in a non-taxable transaction, and the necessary steps were taken thereafter to consolidate the actions now before the court.

Ebasco Industries was engaged in holding various investments during the years 1955 through August 31, 1969, the date of its merger into Boise Cascade. These investments included marketable securities, short-term investments, and ownership interests in various operating subsidiaries which were (and continue to be) engaged primarily in rendering engineering, construction, architectural, and consulting services. Two of such subsidiaries were Ebasco Services,

Inc. (Ebasco) and Chemical Construction Corporation (Chemical Construction). Ebasco Industries owned stock possessing at least 80 percent of the voting power of all classes of stock of those subsidiary corporations.

During the years in question, Ebasco Industries, Ebasco Services, and Chemical Construction, as a part of their investment programs, purchased short-term promissory notes, with no stated interest, issued by various financial and industrial corporations, such as C.I.T. Financial Corporation, General Electric Acceptance Corporation, and General Motors Acceptance Corporation. These notes were nonregistered bearer instruments containing an unconditional promise to pay a specified amount on a specified date at a specified place, and were purchased at a discount, that is to say, for an amount less than their face or maturity value from both issuers and holders. None were held by plaintiffs primarily for sale to customers in the ordinary course of trade or business. The value of such notes would increase over the period of time held through accretions of such original issue discount to the amount paid for the notes.¹

The periods of maturity on the notes ranged from 7 days to 23 months. Some of the notes were disposed of prior to maturity and the rest through retirement at maturity. Although in certain cases the notes sold for a lesser price than the amount paid and the full original discount attributable to the period held by the plaintiffs, all of the gains in question were attributable to such discount. Therefore, all such gains were attributable to the passage of time as opposed to any market fluctuations. All of the notes involved herein were issued after December 31, 1954, and before May 27, 1969; and, with the exception of certain

1. Prices could also vary through market discount and interest fluctuations. There is, however, no gain attributable to such fluctuations at issue herein.

notes held by Chemical Construction in 1960 and 1961, all such notes were held by the plaintiff for a period of not more than six months.

On their books and in their reports to shareholders, plaintiffs accrued the above described discount ratably over the life of the notes and showed it as income in the year earned as opposed to the year of sale or retirement. On their balance sheets these notes were shown at a figure equal to the principal amount less the unamortized portion of the discount at which they were purchased. On their consolidated income tax returns for the years 1955 through 1961, however, the plaintiffs reported all gains in the years in which they were sold or retired. If the notes were held for six months or less, the gain was reported as short-term capital gain; and, after December 31, 1954, the gain on notes held for more than six months was reported as gain from the sale or exchange of noncapital assets.

The plaintiffs' annual shareholder reports included a certification by independent accountants that the financial statements were prepared in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

On audit, the Commissioner of Internal Revenue determined that **the gains on the sale or retirement of notes, regardless of whether held for more than six months**, should be treated as ordinary interest income. The Commissioner also disagreed with the plaintiffs' inclusion of such gains in income entirely in the year realized and determined them to be taxable as they ratably accrued, as per the plaintiffs' book and shareholder report accounting methods.

During the **tax years in issue**, plaintiffs had consolidated net capital losses or consolidated net capital loss carryovers from the five preceding years which exceeded the total amounts taken into income as short-term capital gain so that they reported no income on the gains attributable to

original issue discount on evidences of indebtedness held for six months or less.

In the typical note transaction involved herein, one of the plaintiffs would purchase a note with a face amount of \$1,000,000 for \$980,000 payable in precisely six months. Said notes would not be in registered form and would contain no provision for the payment of interest. Six months later, the note would be retired by the issuing institution for \$1,000,000, resulting in a gain to the particular plaintiff of \$20,000, representing the original issue discount at which the note had been purchased.² As an alternative to retirement, the note might be sold to a third party for the amount paid plus ratably accrued discount.

In 1961 and 1962, Chemical Construction realized gain on the sale or retirement of promissory notes with no stated interest which had been issued at a discount and held for periods of more than six months. These notes were issued after December 31, 1954, were held for investment purposes, and, except for the holding period, were of the same type as the notes described above. Chemical Construction included these amounts on its books and in its shareholder reports as ratably accrued over the life of the several notes. It included these amounts in income for tax purposes, however, in the years of sale or retirement, 1961 and 1962. Plaintiff included these amounts in income as gain from the sale or exchange of property not a capital asset. The Commissioner disagreed with such tax accounting and included the ratably earned amount of discount in income for 1960 and redetermined the amounts for 1961 and 1962.

During the period from 1955 through March 5, 1971, the Commissioner of Internal Revenue did not require the payment of United States income taxes under section 871(a)(1)

2. Such discount in this situation results in an effective annual interest rate of approximately 4.08 percent for the six-month period.

and 881(a) of the Internal Revenue Code of 1954 or the withholding of such taxes under Code sections 1441 and 1442 with respect to original issue discount on bankers' acceptances, commercial paper, and Treasury bills issued after December 31, 1954, and before May 28, 1969, where such evidences of indebtedness were held for not more than six months by nonresident alien individuals or foreign corporations.

In its business, Ebasco Services enters into contracts to perform engineering and similar services. Under the various terms of these contracts, Ebasco is entitled to bill fixed sums either in monthly, quarterly, or other periodic installments, plus such additional amounts as may be provided for in a particular contract. Depending on the terms of the different contracts, payments may in some cases be due prior to the annual period in which such services are to be performed, and in some cases subsequent thereto.

For a number of years prior to 1959 and continuing to the time of trial, Ebasco included in its income for both book and tax purposes amounts attributable to services which it performed during the taxable year, a procedure accepted by the Internal Revenue Service on prior audits. Ebasco determined the amounts so earned by dividing the estimated number of service hours or days required to complete the particular contract into the contract price. The resulting quotient represents an hourly or daily rate which is then multiplied by the number of hours or days actually worked on the contract during the taxable year. As the contract is performed, the rate is adjusted to reflect revised estimates of the work required to complete the contract.

Where Ebasco billed for services prior to the tax year in which they were performed, it credited such amounts to a balance sheet account called "Unearned Income". Where

the services were performed in a subsequent period, the "Unearned Income" account was debited, and such amounts were included in an income account called "Service Revenues". The amount recorded in the latter account was included in income for both book and tax purposes. In determining the amount which was to be included in the "Unearned Income" account, the costs of obtaining the contract were not taken into account;³ and, with the exception of prepaid insurance and similar items, all such amounts were expensed in the tax year during which they were incurred. The amounts in the "Unearned Income" account were treated as liabilities and were excluded from gross income for each tax year consistently in Ebasco's books, records, and shareholder reports, as well as in its tax returns. All of the amounts included in the account during one tax year were earned through the performance of services during the following year and were included in income for such following tax year. When the amounts credited to the "Unearned Income" account were collected, Ebasco had an unrestricted right to the use of such funds.

During the three tax years in issue, an average of over 94 percent of the amounts included in the "Unearned Income" account was received by Ebasco under contracts which obligated it to perform engineering services in connection with the design and construction of electric generating plants. These contracts either required that services be performed by a specified date or required that Ebasco should perform those services "with all reasonable dispatch and diligence," as "expeditiously as possible," or some comparable requirement. The small remaining amounts in the account were received either under contracts which required Ebasco to perform specific services

3. These amounts included the cost of preparing bids, proposals, and estimates, overhead, advertising, and selling expenses.

in connection with a specific project of a client, or required Ebasco to provide consultation and advice on an annual basis for an annual fee.

In addition to its "Unearned" account, Ebasco maintained an "Unbilled Charges" account computed in the same manner as the "Unearned Income" account. The balance in such account represented amounts earned through the rendering of services, or on partially completed contracts, or earned prior to contracting under all of which payment was not then due by the terms of a contract or was not billable and due prior to execution of a future contract. Stated another way, the amounts included in this account were those which Ebasco was not entitled to bill or receive until a year subsequent to the year in which the services were actually rendered. Such amounts were recorded in "Service Revenues" and included in income for tax as well as book purposes in the taxable year in which the services were rendered. Likewise, the costs attributable to the rendering of services which produced the year-end balance in the "Unbilled Charges" account were deducted from gross income in the year such services were rendered. In 1959, 1960, and 1961 there were approximately \$405,000, (\$56,000), and \$179,000 of such net amounts, respectively, carried in the "Unbilled Charges" account.

Plaintiffs' consolidated income tax returns for 1959 through 1961 were audited by the Government, and the amounts in the "Unearned Income" account were included in taxable income for Federal tax purposes. These adjustments were made pursuant to section 446(b) of the 1954 Code under which the Commissioner determined that plaintiffs' deferral method of accounting did not clearly reflect income. During the same examination for the same tax years, no adjustments were made to the "Unbilled Charges" or the "Service Revenues" accounts.

At trial Ebasco presented expert testimony related solely to the accounting practices described above. The sole witness was a qualified certified public accountant and a partner in a major accounting firm. Based on his broad experience with comparable service companies and his personal familiarity with the accounting practices of Ebasco, he expressed his expert opinion with respect to the accounts in issue and the changes made by the Commissioner.

He testified that the method of accounting used by Ebasco which employs both an "Unearned Income" account and an "Unbilled Charges" account and is based on accruing amounts as income at the time the related services are performed is in accordance with recognized and generally accepted accounting principles and clearly reflects Ebasco's income. He indicated that this method properly matched revenues with costs of producing such revenues and is particularly appropriate in this case because almost all of Ebasco's income is derived from the performance of services by its own personnel. He further testified that this method of accounting was widely used by companies engaged in rendering engineering and similar services, and that such method clearly reflected the income of Ebasco.

With respect to costs incurred in obtaining contracts, such as bid preparation, overhead, advertising, and other selling expenses, the witness considered them to be properly deducted in the year incurred as continuing costs of doing and developing business.⁴ He explained that these costs should not properly be amortizable over the life of any particular contract since they were costs connected with new business development and were unrelated to performance of the contract.

4. The witness distinguished such costs from commissions which in some instances may properly be amortized where they relate directly to the contract involved and thus reduce the amount realizable under such contract.

The accounting method proposed by the Commissioner requires Ebasco to accrue as income the amounts included in the "Unearned Income" account and also requires the accrual, consistent with plaintiffs' accounting method, of amounts in the "Unbilled Charges" account. In the opinion of plaintiffs' expert, this method of accounting was not in accordance with generally accepted accounting principles and did not clearly reflect Ebasco's income. To him, the Commissioner's method was erroneous in that it required the inclusion in income of amounts billed but not yet earned on contracts in one accounting period without at the same time acknowledging the obligations and costs to be incurred by Ebasco in the future performance of such contractual commitments. He termed such method as "hybrid" in that while it recognized the accrual method with respect to unbilled charges which were earned but not yet billable, it had the effect of imposing a cash basis method as to the billed but unearned charges in the "Unearned Income" account.

Finally, the witness testified that if Ebasco were to use a method of accounting under which amounts in the "Unearned Income" account would be accrued as income and amounts in the "Unbilled Charges" account would *not* be accrued as income, such method would more clearly reflect the income of Ebasco than the method of accounting proposed by the Commissioner. He stated that, while such method was not technically in accordance with generally accepted accounting principles, it was a more logical and consistent approach to use in determining the income of Ebasco than the Commissioner's method.

The plaintiffs invoke a number of grounds which they believe require the court to decide these consolidated cases in their favor. In their first major contention, they argue that under the provisions of §1232 of the 1954 Code,

original issue discount on evidences of indebtedness held for six months or less is to be characterized as short-term capital gain for tax purposes. They say that (1) §1232 creates a basic rule for capital gains treatment on the sale, exchange, or retirement of evidences of indebtedness and unless original issue discount fits within one of the precise exceptions found in the section, such basic rule will apply; that (2) in carving out an exception to capital gains treatment under §1232, Congress acted purposefully in limiting such exception to gains on the sale or exchange of obligations held for more than six months; that (3) the legislative history surrounding §1232 indicates a Congressional intention that gains on evidences of indebtedness held not more than six months are to be treated as short-term capital gains during the years in issue; and that (4) denial of such treatment as to short-term evidences of indebtedness will result in unlawful discrimination in favor of non-resident alien individuals and foreign corporations during the years in issue. The plaintiffs also contend that bond discount is reportable as income solely in the year of sale or exchange during the tax years in issue.

Plaintiffs' other contentions do not involve bond discount but focus on the methods of accounting employed by plaintiff, Ebasco Services, during certain tax years. The main contention is that the deferral method of income accounting long employed by Ebasco Services clearly reflects income, that the method required by the Commissioner of Internal Revenue does not, and that Ebasco's method, being otherwise allowable, should be found acceptable by the court. As an alternative to this contention, plaintiffs argue that if Ebasco Services is required to accrue deferred income amounts, they should not be required to accrue charges in its "Unbilled Charges" account. Each of these contentions will be treated separately below.

The Original Issue Discount Question

During the years at issue, there can be little doubt that original issue discount realized on the sale or exchange (including retirement) of evidences of indebtedness held *for six months or less* must be characterized as short-term capital gain. To sustain defendant's contrary contention that plaintiffs merely received ordinary interest income from such original issue discount would require the court to rewrite the applicable Code provision, section 1232(a)(2), by the simple expedient of eliminating therefrom the crucial words "held by the taxpayer more than 6 months." But, as will be shown, nothing in the legislative history of the statute or in the decided cases requires such extraordinary mental gymnastics by this court.

Section 1232 was derived from section 117(f) of the Internal Revenue Code of 1939 which treated redemption as a sale or exchange of the evidences of indebtedness issued by a corporation (including any government or political subdivision thereof), which were in registered form or had coupons attached. Section 1232 abandoned the "registered form" or "coupons attached" requirements and extended capital gain or loss treatment to all bonds or other evidences of indebtedness issued after December 31, 1954, if they were otherwise capital assets. Section 1232, however, provided exceptions to this characterization with regard to certain original issue discount. Under the statute, original issue discount is defined as the difference between the issue price and the stated redemption price at maturity (*i.e.*, the face value). If the particular indebtedness was issued after December 31, 1954, and held by the taxpayer for more than six months, such discount would be considered as gain from the sale or exchange of property which is not a capital asset. Gain attributable to discount on

evidences of indebtedness held for six months or less was not mentioned in the statute.⁵

As might readily be expected, counsel for plaintiffs find great significance in this Congressional failure to mention specifically original issue discount on evidences of indebtedness held *for six months or less*, and from this they argue that traditional capital gain or loss treatment continues to apply to such evidences of indebtedness provided only that they are otherwise capital assets and have been held by the taxpayer for six months or less. The pertinent parts of the statute read:

SEC. 1232. *Bonds and Other Evidences of Indebtedness.*

(a) *General Rule.*—For purposes of this subtitle, in the case of bonds, debentures, notes, or certificates or other evidences of indebtedness, which are capital assets in the hands of the taxpayer, and which are issued by any corporation, or government or political subdivision thereof * * *

* * *

(2) *Sale or Exchange.*—

(A) *General Rule.*—* * * [U]pon sale or exchange of bonds or other evidences of indebtedness issued after December 31, 1954, held by the taxpayer more than 6 months, any gain realized which does not exceed—

(i) an amount equal to the original issue discount (as defined in subsection (b)) * * *

shall be considered as gain from the sale or exchange of property which is not a capital

5. The statute was subsequently amended by the Tax Reform Act of 1969, P. L. 91-172, 83 Stat. 487, so that gain attributable to original issue discount on evidences of indebtedness held for six months or less is currently characterized as ordinary income by the terms of the statute.

asset. Gain in excess of such amount shall be considered gain from the sale or exchange of a capital asset held more than 6 months.

* * *

(b) *Definitions.*—(1) *Original issue discount.*—For purposes of subsection (a), the term “original issue discount” means the difference between the issue price and the stated redemption price at maturity. If the original issue discount is less than one-fourth of 1 percent of the redemption price at maturity multiplied by the number of complete years to maturity, then the issue discount shall be considered to be zero.⁶ * * *

In searching for the proper interpretation of section 1232, as applied to the present problem, the intent of Congress in enacting the section becomes highly relevant. That intention is clearly manifested by language found in both the Reports of the Committee on Ways and Means and the Committee on Finance where it is stated:

Paragraph (1) restates the content of present law. For bonds or other evidences of indebtedness issued after December 31, 1954, the bill abandons present restriction of capital treatment on retirement to bonds and other evidences of indebtedness which have interest coupons attached or which are in registered form. *Redemption of all bonds and other evidences of indebtedness will receive capital gain or loss treatment on redemption if issued after December 31, 1954, and if they are otherwise capital assets, except to the extent that the recovery of issue discount is subject to paragraph (2) [i.e. section 1232(a)(2)].* (House Report No. 1337, 83d Cong., 2d Sess., p. A275.) [Emphasis supplied.]

6. The foregoing is a pertinent extract from the statute involved, as amended by the Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606. The amendments made thereby were merely technical and clarifying in nature without substantive relevance to the issue involved herein.

The Report of the Committee on Finance contains an identical statement. See Senate Report 1622, 83d Cong., 2d Sess., p. 433.

Defendant makes light of the foregoing and relies instead on committee explanations that original issue discount “is a form of interest income and in fact is deductible as an interest payment by the issuing corporation.” See, H. Rep. No. 1337 and S. Rep. No. 1622, *supra*. The statement quoted is, of course, correct and accurately reflects such decisions of the U. S. Supreme Court as *United States v. Midland-Ross Corporation*, 381 U.S. 54, 57 (1965) and *Helvering v. Union Pacific Ry. Co.*, 293 U.S. 282 (1934). Cf. *Commissioner v. National Alfalfa Dehydrating & Milling Co.*, U.S. , 42 U.S.L.W. 4798, 4801, decided May 28, 1974, on the narrow question of whether discount may result when debt obligations are issued in exchange for property other than cash.⁷

7. In footnote 9 of its *National Alfalfa* opinion, the Court made a generalized comment on the section 1232(a)(2) problem as follows:

It was unsettled for some time whether income realized by an owner of an original discount obligation was taxable to that owner as ordinary income or as capital gain. In *Commissioner v. Caulkins*, 144 F.2d 482 (CA6 1944), decided under the 1939 Code, it was held that gain upon surrender of an installment certificate issued at a discount was capital gain. Other circuits, however, thereafter held that income attributable to the discount was ordinary income. * * * [Citing cases.]

The issue was settled by the decision in *United States v. Midland-Ross Corp.*, 381 U.S. 54 (1965), when the Court held that earned original issue discount is not entitled to capital gain treatment under the 1939 Code.

Congress, in enacting § 1232 of the 1954 Code, adopted a different approach to earned original issue discount, referring to it as “a form of interest income” in S. Rep. No. 1622, 83d Cong., 2d Sess., 112 (1954). Under § 1232(a)(2), gain from the sale or redemption of a corporate obligation issued at a discount is taxed as the gain from the sale of a noncapital asset. If the obligation is held by the original purchaser to maturity, the entire amount of the discount is so taxed, but if it is sold or

In *Midland-Ross, supra*, the Supreme Court gave consideration to non-interest bearing promissory notes originally issued at a discount most of which had been held by the taxpayer for over six months but one of which was held for six months or less (as in the present case). It was conceded by the parties that any gain attributable to such discount was the economic equivalent of interest in compensation for the use of money. The taxpayer had, nonetheless, reported such gain as capital gain under section 117 of the 1939 Code. In holding against the taxpayer, the Court premised its decision on the narrow construction traditionally given the term, "capital asset." Thus, at 381 U.S. 54, 56-57:

* * * Although original issue discount becomes property when the obligation falls due or is liquidated prior to maturity and § 117(a)(1) defined a capital asset as "property held by the taxpayer," we have held that

not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset. This Court has long held that the term "capital asset" is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation of the entire gain in one year. *Commissioner v. Gillette Motor Co.*, 364 U.S. 130, 134.

See also *Corn Products Co. v. Commissioner*, 350 U.S. 46, 52. In applying this principle, this Court

redeemed before maturity, only the portion accrued up to the date of sale or redemption is so taxed. * * *

It will be seen that these observations do not quite reach the precise issue here involved. For an extensive discussion of *National Alfalfa*, see comment in 41 Jour. of Tax. 134 (Sept. 1974).

has consistently construed "capital asset" to exclude property representing income items or accretions to the value of a capital asset themselves properly attributable to income. * * *

* * *

* * * Similarly, earned original issue discount cannot be regarded as "typically involving the realization of appreciation in value accrued over a substantial period of time . . . [given capital gains treatment] to ameliorate the hardship of taxation of the entire gain in one year."

Earned original issue discount serves the same function as stated interest, concededly ordinary income and not a capital asset; it is simply "compensation for the use or forbearance of money." * * *

This court had itself anticipated the decision in *Midland-Ross*. See, *Pattiz v. United States*, 160 Ct. Cl. 121, 311 F.2d 947, (1963) where, speaking for a unanimous court, Judge Whitaker observed at 160 Ct. Cl. 127, 311 F.2d 950:

We think this * * * correctly states the sort of gain Section 117(f) was intended to cover and the part it was not intended to cover. It was intended to cover gain derived from appreciation in value, or a case where the purchase was made from some one other than he who issued them at an advantageous price, but certainly not a case where an original issue of bonds or notes were sold at a discount, in lieu of payment of interest on them.

* * *

Thus, on the basis of *Midland-Ross* and *Pattiz*, it is entirely clear that under the 1939 Code, the discounted short-term obligations owned by plaintiffs would produce income in the nature of interest and hence taxable at ordi-

nary rates.⁸ This conclusion, however, cannot be the end of the matter.

The present cases arise under section 1232 of the 1954 Code, not under section 117 of the 1939 Code. In *Midland-Ross*, the Supreme Court expressly disavowed any intention to rule on the provisions of section 1232 of the 1954 Code, stating that it had "no view on the construction of this statute." 381 U.S. 54, 58, fn. 5.⁹ Much later, the Court in *National Alfalfa, supra*, referred to section 1232 of the 1954 Code as having "adopted a different approach to earned original issue discount, referring to it as 'a form of interest income . . .'". See footnote 7, *supra*.

Unlike the situation in *Midland-Ross*, I believe that in the present cases, plaintiffs have established that Congress in enacting section 1232 of the 1954 Code intended to treat sales or exchanges of evidences of indebtedness as capital transactions and to carve out from such treatment certain exceptions including gain attributable to original issue discount on evidences of indebtedness held for more than six months. Plaintiffs have further established to my satisfaction that Congress intended to treat gains which were not subject to the exceptions provided in section 1232, such as original issue discount on evidences of indebtedness held for not more than six months, as short-term capital gains. Adopting the defendant's position to the contrary would necessarily require the court to rewrite section 1232(a)(2) by simply ignoring the words "held by the taxpayer more than 6 months." I cannot believe that such drastic rewriting of the statute would constitute permissible interpretation.

8. See 1954 Code, § 61(a)(4), 26 U.S.C. § 61(a)(4), and Treas. Reg. § 1.61-7(a) and (c).

9. Similarly, this court concluded in *Pattis, supra*, that:

The 1954 Code does not affect the transaction in this case. *The 1954 Code effected a change in the law.* 160 Ct. Cl. 128, 311 F.2d 950 [Emphasis supplied.]

Neither party has made reference to legislative history (and I have found none independently) which satisfactorily explains the reason why Congress in enacting section 1232(a)(2) used the words "held by the taxpayer more than 6 months"—traditional words typically used by Congress only in the capital gain and loss provisions of the various revenue statutes. If, as defendant apparently contends, Congress in section 1232 intended to provide that all original issue discount should be taxed as though it were simply interest income, statutory language to that effect could have been easily framed.¹⁰ Is it possible that the obvious failure to do so is merely an instance of what Judge Nichols has referred to as "sheer inadvertence in the legislative process"? Dissenting in *Schmid v. United States*, 193 Ct. Cl. 780, 789, 436 F. 2d 987, 992 (1971), and cited with approval by the Supreme Court in *Cass v. United States*, U.S. , decided May 28, 1974, slip op. p. 11.

That some inadvertence might have existed is perhaps indicated by the fact that in section 413(a) of the Tax Reform Act of 1969, P. L. 91-172, 83 Stat. 487, Congress amended section 1232 of the 1954 Code to make it apply to discount on corporate bonds *held for not more than six months*, provided they were issued after May 27, 1969. However, in explaining the change, the Report of the Committee on Finance stated:

The rules provided by the bill regarding the treatment of original issue discount are not to apply in the case of bonds or other evidences of indebtedness issued by any government or political subdivision (or in the case of bonds or other evidence of indebtedness issued by a corporation on or before October 9,

10. This principle was referred to by the late Judge Jerome Frank as the "familiar easy-to-say-so-if-that-is-what-was-meant rule." *Commissioner v. Beck's Estate*, 129 F.2d 243, 245 (2d Cir., 1942).

1969). In these cases, the rules of present law regarding the treatment of original issue discount on the sale or exchange of a bond which is a capital asset in the hands of the taxpayer and which has been held by the taxpayer for more than 6 months are to continue to apply. *In addition, in these cases, gain on the sale or exchange of a bond or other evidence of indebtedness which is a capital asset in the hands of the taxpayer but which has not been held by the taxpayer for more than 6 months is to be treated as a short-term capital gain as under present law.* (Senate Report No. 91-552, 91st Cong., 1st Sess., p. 148, 1969-3 C.B. 423, 518) [Emphasis supplied.]

While it is true, as suggested by defendant, that the views of a subsequent Congress form a hazardous basis for ascertaining the intent of an earlier one,¹¹ the significance of the above excerpt is its indication of Congressional understanding of this area of law which would seem to negate the possibility of inadvertence. Whether the Congressional actions described above (resulting, as they do, in a form of so-called "loophole") reflect sound tax policy is not a question for the judiciary. In this connection, the words of Mr. Justice Stewart in *United States v. Correll*, 389 U.S. 299 (1967) should be borne in mind:

... we do not sit as a committee of revision to perfect the administration of the tax laws. 389 U.S. 306-307.

11. *United States v. Price*, 361 U.S. 304, 313 (1960); *United States v. Philadelphia Nat. Bank*, 374 U.S. 321, 348-349 (1963); *Waterman S. S. Corp. v. United States*, 381 U.S. 252, 269 (1965); *United States v. Southwestern Cable Co.*, 392 U.S. 157, 170 (1968); *Brown v. United States*, 192 Ct. Cl. 203, 210, 426 F.2d 355, 357 (1970); and *Humble Oil & Refining Co. v. United States*, 194 Ct. Cl. 920, 932, 442 F.2d 1362, 1369 (1971).

Accordingly, I conclude that gains attributable to original issue discount on evidences of indebtedness issued prior to May 28, 1969, and held for not more than six months should be treated as short-term capital gains.¹²

"SECOND ISSUE OMITTED"

• • •

Recommended Conclusion of Law

Upon the foregoing findings of fact and opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover, and judgment is entered to that effect, with the determination of the amount of recovery to be reserved for further proceedings under Rule 131(c) in accordance with this opinion.

12. In the view I take of the case, this conclusion renders moot two subsidiary points raised by the parties. First, plaintiff argues that defendant's treatment of original issue discount in the present case is so different from the treatment accorded such discount in the hands of non-resident aliens and foreign corporations as to be illegally discriminatory in favor of foreign persons and against United States persons. However, should my view of the law prevail, there is no such discrimination, and the question becomes moot. Secondly, while conceding that gain attributable to original issue discount on evidences of indebtedness *held for more than 6 months* is taxed only in the year realized through sale or exchange (Df's Brief, p. 24), defendant contends that on short-term evidences of indebtedness held by accrual basis taxpayers (such as plaintiffs), the original issue discount is taxable on a ratably accrued basis in the same manner as ordinary interest income. However, my treatment of such discount as short-term capital gain places the question within the general scope of defendant's concession that discount on longer term evidences of indebtedness is taxable only when realized, thus eliminating the question.

B-1

APPENDIX B

**IN THE
UNITED STATES COURT OF CLAIMS**

Nos. 321-69, 81-71

(Decided January 28, 1976)

BOISE CASCADE CORPORATION AND SUBSIDIARY COMPANIES,

v.

THE UNITED STATES

Norton Kern, attorney of record for plaintiff. *Lawrence C. Wilson, Reid & Priest*, of counsel.

Donald H. Olson, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

Before *LARAMORE, Senior Judge*, *DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG*, and *BENNETT, Judges*.

Opinion

PER CURIAM: These are consolidated cases, in which plaintiffs seek the recovery of nearly \$2,400,000 in income taxes plus interest thereon, paid for the years 1955 through 1961. They now come before the court on exceptions by the parties to the recommended decision filed by Trial Judge Lloyd Fletcher, on September 20, 1974, pursuant to Rule

134(h), having been submitted to the court on the briefs and oral argument of counsel. He held for the plaintiffs on all the significant issues. After briefing and oral argument, the court agrees with the trial judge in part, and disagrees in part. Our disagreement extends to all the portions of the opinion that deal with plaintiffs' gains from original issue discount. In *General Foods Corporation v. United States*, No. 70-73 (decided today), the stipulated facts as to this issue offer no legal distinction from the found facts at bar. The court has there held that the gains attributable to original issue discount, on evidences of indebtedness issued after December 31, 1954, and before May 28, 1969, and held by plaintiff for periods of not more than six months, were ordinary income rather than short term capital gains. Moreover, it has held that any alleged inconsistent treatment of foreign taxpayers by the Internal Revenue Service does not affect the validity of its position. Accordingly, the discount was taxable currently as earned by these accrual basis taxpayers. In view of our full statement of reasons in *General Foods*, to which reference is made, it is unnecessary to repeat it here. The fact findings are left standing. Though not printed herewith, they have been furnished to the parties, and will suffice to document the identity of issues.

"SECOND ISSUE OMITTED"

• • •

DAVIS, *Judge*, concurring: On the issue of original issue discount, I refer to my concurring opinion in *General Foods Corp. v. United States*, No. 70-73. On the so-called "accounting" issue, I join the court in adopting (with some modifications) Trial Judge Fletcher's opinion.

Conclusion of Law

Upon the findings of fact and opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover on the accounting issue and judgment is entered to that effect, with the determination of the amount of recovery to be reserved for further proceedings under Rule 131(c) in accordance with this opinion. Judgment is entered for defendant and the petitions are dismissed with respect to original issue discount.

C-1

APPENDIX C

IN THE

UNITED STATES COURT OF CLAIMS

Nos. 321-69, 81-71

BOISE CASCADE CORPORATION AND SUBSIDIARY COMPANIES

v.

THE UNITED STATES

Before DAVIS, *Judge*, Presiding, LARAMORE, *Senior Judge*,
SKELTON, NICHOLS, KASHIWA, KUNZIG and BENNETT, *Judges*,
en banc.

Order

In the court's per curiam opinion of January 28, 1976,
there occurs an inadvertent error which the court *sua*
sponte corrects by this order.

References are to the slip opinion:

Page 2, Line 7; Delete entire sentence reading:

Moreover, it has held * * * validity of its position.
Page 2, following line 16 (end of above paragraph) insert
new paragraph reading:

With respect to the claim of unlawful discrimina-
tion in favor of nonresident taxpayers, in that the
Commissioner failed to tax as ordinary income origi-
nal issue discount on their indebtedness held for six
months or less, the court is of the opinion that the
taxation of nonresident foreign taxpayers raises
such different considerations that it cannot be com-
pared, for equal protection purposes, to the taxation
of domestic taxpayers.

By the Court

OSCAR H. DAVIS

Oscar H. Davis,

Judge, Presiding.

Feb 27 1976

D-1

APPENDIX D
IN THE
UNITED STATES COURT OF CLAIMS

No. 70-73
(Decided January 28, 1976)

GENERAL FOODS CORPORATION,

v.

THE UNITED STATES

David I. Granger, attorney of record, for plaintiff. Harold D. Murry, Jr. and Clifford, Warnke, Glass, McIlwain & Finney, of counsel.

Richard F. Treacy, Jr., with whom was Assistant Attorney General Scott P. Crampton, for defendant. Theodore D. Peyser and Donald H. Olson, of counsel.

Before LARAMORE, Senior Judge, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG, and BENNETT, Judges.

OPINION

KASHIWA, Judge, delivered the opinion of the court:

This action comes before us on a stipulation of facts. The essential facts stipulated are recited below. Each of the parties claims that it is entitled to judgment on said stipu-

lated facts. We hold for the defendant and against the plaintiff for reasons hereafter stated.

This is an action arising under the Internal Revenue Code of 1954 for the taxable year 1959, beginning April 1, 1958, and ending March 31, 1959. Since Section 1232 of the Internal Revenue Code of 1954 is the center of discussion, we shall first quote by footnote its relevant portions.¹

1. SEC. 1232. BONDS AND OTHER EVIDENCES OF INDEBTEDNESS.

"(a) GENERAL RULE.—For purposes of this subtitle, in the case of bonds, debentures, notes, or certificates or other evidences of indebtedness, which are capital assets in the hands of the taxpayer, and which are issued by any corporation, or government or political subdivision thereof—

"(1) RETIREMENT.—Amounts received by the holder on retirement of such bonds or other evidences of indebtedness shall be considered as amounts received in exchange therefor (except that in the case of bonds or other evidences of indebtedness issued before January 1, 1955, this paragraph shall apply only to those issued with interest coupons or in registered form, or to those in such form on March 1, 1954).

"(2) SALE OR EXCHANGE.—

"(A) GENERAL RULE.—Except as provided in subparagraph (B), upon sale or exchange of bonds or other evidences of indebtedness issued after December 31, 1954, held by the taxpayer more than 6 months, any gain realized which does not exceed—

"(i) an amount equal to the original issue discount (as defined in subsection (b)), or

"(ii) if at the time of original issue there was no intention to call the bond or other evidence of indebtedness before maturity, an amount which bears the same ratio to the original issue discount (as defined in subsection (b)) as the number of complete months that the bond or other evidence of indebtedness was held by the taxpayer bears to the number of complete months from the date of original issue to the date of maturity,

"shall be considered as gain from the sale or exchange of property which is not a capital asset. Gain in excess of such amount shall be considered gain from the sale or exchange of a capital asset held more than 6 months.

"(B) EXCEPTIONS.—This paragraph shall not apply to—

Plaintiff, General Foods Corporation, is a corporation duly organized and existing under the laws of the State of Delaware, with its principal place of business at White Plains, New York. The stipulation shows that General Foods Corporation's principal business is the production and sale of a wide variety of food and grocery products, many in package form under nationally advertised brand names. General Foods Corporation is not now, nor has it ever been, a dealer in securities. During the taxable year 1959, plaintiff held promissory notes with no stated interest issued by various corporations. The notes, commonly referred to as commercial paper, were non-registered bearer instruments containing an unconditional promise to pay a specified amount on a specified date at a specified place. Plaintiff purchased each of the notes from the issuer or from Goldman, Sachs & Company, a dealer in securities, at an amount less than its face value. The notes were held by plaintiff for periods ranging from 43 days to 181 days. The plaintiff held each note for a period less

"(i) obligations the interest on which is not includible in gross income under section 103 (relating to certain governmental obligations), or

"(ii) any holder who has purchased the bond or other evidence of indebtedness at a premium.

"(C) DOUBLE INCLUSION IN INCOME NOT REQUIRED.—This section shall not require the inclusion of any amount previously includible in gross income.

"(b) DEFINITIONS.—

"(1) ORIGINAL ISSUE DISCOUNT.—For purposes of subsection (a), the term "original issue discount" means the difference between the issue price and the stated redemption price at maturity. If the original issue discount is less than one-fourth of 1 percent of the redemption price at maturity multiplied by the number of complete years to maturity, then the issue discount shall be considered to be zero. For purposes of this paragraph, the term "stated redemption price at maturity" means the amount fixed by the last modification of the purchase agreement and includes dividends payable at that time."

* * * * *

[As amended through 1959.]

than six months and at maturity received the face amount from the issuer. Plaintiff retired all of the notes in the taxable year 1959. The notes were purchased by the plaintiff for investment and were not property of a type that would be held in inventory or for sale to customers in the normal course of business. All of the notes involved in this case were issued after December 31, 1954, and before May 27, 1969. The amount received by the plaintiff on retirement of each of the notes which exceeded the amount paid by plaintiff for the note was original issue discount; no part of that amount was attributable to market fluctuations as opposed to the passage of time.

On its Federal income tax return for the taxable year 1959, beginning April 1, 1958, and ending March 31, 1959, plaintiff reported short-term capital gains of \$608,598.99. This was the amount received over and above the purchase prices from the retirement at maturity of the total of \$90,750,000 non-interest-bearing corporate notes purchased by the plaintiff at a discount and held for less than six months. During the taxable year 1959 plaintiff had net capital loss carryovers from the prior years in the amount of \$518,840.74. There is no dispute as to this loss carryover. Plaintiff claims that it is entitled to deduct the loss carryover from the above-mentioned gain of \$608,598.99 because the gain is short-term capital gain.

On October 29, 1965, the Commissioner of Internal Revenue mailed to the plaintiff a statement of tax due, assessing a deficiency in income taxes for the taxable year 1959 in the amount of \$345,638 plus interest. Plaintiff paid this amount plus interest on November 8, 1965. The amount of \$208,291 of this deficiency assessment resulted from the Commissioner treating as interest income rather than as short-term capital gain the amount of \$608,598.99 received by plaintiff over and above the purchase prices on the retirement at

maturity of the non-interest-bearing corporate notes purchased by the plaintiff at a discount for investment and held for less than six months. On November 6, 1967, plaintiff filed a claim for refund of this amount of \$208,291 plus the interest paid thereon together with interest as provided by law, representing that part of the assessed deficiency attributable to treating as interest income rather than short-term capital gain the amounts over and above the purchase prices, received by plaintiff on the retirement of the corporate notes. On March 1, 1971, the Commissioner of Internal Revenue disallowed in its entirety plaintiff's claim for refund. This action for refund was filed in this court on February 27, 1973.

Both parties agree that the sole issue presented is whether gain attributable to original issue discount on evidences of indebtedness issued after December 31, 1954, and before May 28, 1969, and held by plaintiff for periods of not more than six months is taxable as short-term capital gain on the retirement of the indebtedness.

The decision in this case rests, as we shall hereafter show, upon Section 1221 but since plaintiff's arguments center on Section 1232, we shall first examine Section 1232. Plaintiff claims that Section 1232 gives capital treatment to the gain in this case. Defendant, on the other hand, states that Section 1232 is not relevant to the original issue discount herein since Section 1232 only deals with notes which are capital assets in the hands of the taxpayer and since original issue discount under case law is not a capital asset, Section 1232 does not apply.

We shall first discuss the history of Section 1232. Section 206(a)(1) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 232, defined the term "capital gain" as "taxable gain from the sale or exchange of capital assets * * *." This provision, without material change, was reenacted by Sec-

tion 208(a)(1) of the Revenue Act of 1924, c. 234, 43 Stat. 253, 262; by Section 208(a)(1) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 19; by Section 101(c)(1) of the Revenue Act of 1928, c. 852, 45 Stat. 791, 811; and by Section 101(c)(1) of the Revenue Act of 1932, c. 209, 47 Stat. 169, 191.

The question arose as to whether, under these statutes, a redemption (retirement) of bonds constituted a sale or exchange within the meaning of that provision and successor statutes. A conflict of judicial decisions² on the matter led Congress to enact Section 117(f) of the Revenue Act of 1934, c. 277, 48 Stat. 680, 715, which is the predecessor of Section 1232(a)(1). The addition of that provision assured that the retirement of notes would constitute an exchange.

While Section 117(f) served to resolve the question of whether the *retirement* of a note constituted a "safe [sic] or exchange," it created a new round of litigation as to whether gain attributable to original issue discount was an amount received in exchange for a capital asset and, consequently, qualified for long-term capital gain treatment. In *Commissioner v. Caulkins*, 144 F. 2d 482 (6th Cir. 1944), the Sixth Circuit read Section 117(f) to permit long-term capital gain treatment for the \$5,000 gain realized, functionally, as original issue discount. The court noted (at 484) that if the application of Section 117(f) resulted in inconsistencies and inequalities, "the correction of this defect in the operation of the statute is for Congress and not for the courts." The Supreme Court in *United States v. Midland-Ross Corp.*, 381 U.S. 54 (1965), subsequently disagreed with the holding of *Caulkins* that the proceeds received upon a face-amount certificate cannot be divided into separate increments which represent interest income and capital gain after other

2. See *Fairbanks v. United States*, 306 U.S. 436 (1939).

courts, including this court, refused to follow the rationale of the Sixth Circuit. See *Pattiz v. United States*, 160 Ct. Cl. 121, 311 F. 2d 947 (1963); *Commissioner v. Morgan*, 272 F. 2d 936 (9th Cir. 1959); *Rosen v. United States*, 288 F. 2d 658 (3d Cir. 1961); *United States v. Harrison*, 304 F. 2d 835 (5th Cir. 1962), *cert. denied*, 372 U.S. 934 (1963).

The legislative history of the revised version of Section 117(f) (Section 1232) indicates that Congress chose to heed the admonition of the court in *Caulkins* to correct, at least partially, a possible defect in the statute which, under the holding of *Caulkins*, allowed the issuing corporation an interest deduction for original issue discount, but taxed the holder at more favorable long-term capital gain rates if the notes were held more than six months. The following language of the Senate Report accompanying the enactment of Section 1232 of the 1954 Code graphically illustrates the situation which Congress faced at the time (S. Rep. No. 1622, 83d Cong., 2d Sess. 112 (1954)):

(C) *Bonds and Other Debt (sec. 1232)*

(1) *House changes accepted by committee*

Under section 117(f) of present law, when a corporate or Government bond in registered form or with coupons attached is retired the transaction is treated as a sale or exchange. There is some uncertainty as to the status of proceeds in these transactions, i.e., as capital gain or as interest income where the bond or other evidence of indebtedness has been issued at a discount (see I.T. 3486, 1941-2, C.B. p. 76, as compared with *Comm. v. Caulkins*, 144 F. 2d 482). In these cases, that part of the amount received on a sale or exchange which may represent a partial recovery of discount on original issue is a form of interest income and in fact is deductible as an interest payment by the issuing corporation.

Effective with respect to bonds issued after December 31, 1954, the House bill removes doubt in this area by providing that any gain realized by the holder of a bond attributable to the original issue discount will be taxed as ordinary income. * * *

The solution to the problem perceived by Congress as a result of *Caulkins* was a limited one. Together with other technical amendments to the old Section 117(f), which amendments have no effect on the instant problem, Congress added subsection (a)(2) to Section 1232 to plug the revenue loss resulting from the allowance, under *Caulkins*, of long-term capital gain treatment.

Congress reenacted most of the text of Section 117(f) as Section 1232(a) of the 1954 Code and specifically added the limiting language "which are capital assets" to the language "bonds, debentures, notes, or certificates or other evidences of indebtedness." It explained this addition as follows (S. Rep. No. 1622, *supra*, at 434):

Section 117(f) does not itself extend capital-gain treatment to any transaction but simply provides one of several requirements for such treatment on retirement of certain securities. Paragraph (2) of this section [Section 1232], however, provides specifically for capital-gain treatment and, therefore, the phrase is inserted in the first sentence of this section to the effect that this section only applies to bonds and other evidences of indebtedness *which are capital assets* in the hands of the taxpayer. * * * [Emphasis supplied.]

We turn now from the history to the present positions of the parties. Plaintiff first argues that Section 1232(a)(1) makes the retirement of these notes equal to an exchange. Since the section does not provide for special treatment of original issue discount for notes held six months or less as

it does for original issue discount on notes held more than six months in Section 1232(a)(2), notes held for six months or less fall under Section 1232(a)(1). Their retirement is treated as an exchange and an exchange of a capital asset results in capital gain.

This is the point at which the parties separate. The defendant states that Section 1232(a)(1) does not apply; in fact, none of Section 1232 applies. In Section 1232(a) the general rule refers to notes "which are capital assets in the hands of the taxpayer." Defendant argues that under case law the original issue discount is separable from the note and is not a capital asset. Since Section 1232 is only applicable to capital assets, it does not apply to original issue discount on notes held for six months or less. Therefore, we must examine the case law to determine how this item should be treated.

It has been held by the Supreme Court and other courts that an item of ordinary income derived from an income-producing capital asset retained its character even though sold as part of property which was a capital asset.³ In *United States v. Midland-Ross Corp.*, *supra*, the Supreme Court held that original issue discount was ordinary income and not capital gain. The Court held as follows at 56-57:

3. *Watson v. Commissioner*, 345 U.S. 544 (1953) [profit from sale of an orange grove attributable to unmaturing crop was ordinary income]; *Commissioner v. Gillette Motor Transport, Inc.*, 364 U.S. 130 (1960) [award for wartime possession of trucking company by Government was rental income and not capital gain from involuntary conversion]; *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260 (1958) [consideration for assignment of oil payment right carved out from a larger mineral interest producing ordinary income was held to be taxable as ordinary income]; *Tunnell v. United States*, 259 F. 2d 916 (3d Cir. 1958) [proceeds of sale of interest in law partnership, to the extent attributable to accounts receivable, were taxable as ordinary income]; *Fisher v. Commissioner*, 209 F. 2d 513 (6th Cir. 1954) *cert. denied*, 347 U.S. 1014 [proceeds of sale of notes representing defaulted interest were ordinary income].

* * * Although original issue discount becomes property when the obligation falls due or is liquidated prior to maturity and § 117(a)(1) defined a capital asset as "property held by the taxpayer," we have held that

"not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset. This Court has long held that the term 'capital asset' is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation of the entire gain in one year." *Commissioner v. Gillette Motor Co.*, 364 U.S. 130, 134.

See also *Corn Products Co. v. Commissioner*, 350 U.S. 46, 52. In applying this principle, this Court has consistently construed "capital asset" to exclude property representing income items or accretions to the value of a capital asset themselves properly attributable to income. * * * [Footnote omitted.]

In an earlier decision in *Pattiz v. United States*, *supra*, this court held as follows:

We think the discount at which these notes were sold was in lieu of the payment of interest on them, and that the difference in the amount paid for them and the amount at which they were redeemed was ordinary income. In our opinion it was not intended by § 117(f) of the Internal Revenue Code of 1939 to treat it as a capital gain. [160 Ct. Cl. at 128, 311 F. 2d at 950.]

Judge Whitaker in his *Pattiz* opinion examines the relevant cases of several circuits and comes to the conclusion that Section 117(f), the predecessor of Section 1232(a)(1), was

intended to cover capital gain resulting from the retirement of a note in contrast to original issue discount gain representing compensation for the use of money.

That decision agrees with the Third Circuit's conclusion in *Rosen v. United States*, *supra*. In *Rosen* the taxpayer argued that Section 1232(a)(1) was an overriding statute which prevented original issue discount from being taxed as interest under Section 61. The court at 661 stated the issue to be:

* * * whether the requirement of Section 1232(a)(1) that amounts received on retirement of certain "evidences of indebtedness shall be considered as amounts received in exchange therefor" is tantamount to saying that the entire increment realized in such an exchange must be taxed as capital gain rather than ordinary income.

The court then looked at the tax treatment of fully earned increments upon the sale or exchange of capital assets and concluded that the general rule applies: the right to receive ordinary income from a capital asset is not changed into capital gain upon the sale of that asset together with the right. Section 1232(a)(1) did not abrogate that rule but, rather, provided for capital treatment for the capital increment which was realized upon retirement.

Plaintiff seizes upon a sentence in a Senate Committee on Finance Report to the Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487,⁴ to argue that Section 1232 was intended

4. S. Rep. No. 91-552, 91st Cong., 1st Sess. (1969) at 148:

"* * * In * * * [the case of Government evidences of indebtedness or in the case of pre-October 10, 1969, corporate evidences of indebtedness] gain on the sale or exchange of a bond or other evidence of indebtedness which is a capital asset in the hands of the taxpayer but which has not been held by the taxpayer for more than 6 months is to be treated as a short-term capital gain as under present law."

to overrule *Midland-Ross, supra*. This statement was made without any basis in the 1954 version of Section 1232. The views of a subsequent Congress as to the meaning of ambiguous language of a previous Congress do not carry great weight.⁵ An attempt to amend legislation of a previous Congress by Committee Report must be rejected.

Plaintiff also states that it should prevail because the Commissioner unlawfully discriminated in favor of similarly situated taxpayers. The basis of this claim is that the Commissioner failed to tax as ordinary income original issue discount on evidences of indebtedness held for six months or less by nonresident alien individuals and foreign corporations. In plaintiff's claim for refund no mention is made of a claim of unlawful discrimination. Accordingly, this court is without jurisdiction to rule upon a claim not set out in plaintiff's claim for refund. See Section 7422(a) of the 1954 Code and Treas. Reg. § 301.6402-2(b)(1) (1956); *Union Pacific R.R. v. United States*, 182 Ct. Cl. 103, 108, 389 F. 2d 437, 442 (1968), and the cases cited therein.

We find for the defendant and against the plaintiff. Plaintiff's petition is dismissed. Judgment is entered for the defendant and against the plaintiff.

DAVIS, *Judge*, concurring in the result:

My vote to dismiss the petition is not founded on the use in section 1232 of "capital assets," the primary purpose of which I take to be to separate securities held for investment from those held in the ordinary course of trade or business.

5. *United States v. Price*, 361 U.S. 304, 313 (1960); *United States v. Philadelphia National Bank*, 374 U.S. 321, 348-49 (1963); *Waterman Steamship Corp. v. United States*, 381 U.S. 252, 269 (1965); *United States v. Southwestern Cable Co.*, 392 U.S. 157, 170 (1968); *Brown v. United States*, 192 Ct. Cl. 203, 210, 426 F.2d 355, 357 (1970); and *Humble Oil & Refining Co. v. United States*, 194 Ct. Cl. 920, 932, 442 F.2d 1362, 1369 (1971).

Rather, I am moved by the simple fact that section 1232 fails to deal at all with original issue discount on securities held for no more than six months, and therefore must conclude that the applicable rule, even under the 1954 Code, was the "economic reality" of *United States v. Midland-Ross Corp.*, 381 U.S. 54 (1965), that such discount is equivalent to interest. Taxpayers can point to no part of section 1232 which lays down the treatment for original issue discount on bonds held for no more than six months. Subsection (a)(2)(A), as everyone agrees, is restricted on its face to evidences of indebtedness held for more than six months; subsection (a)(1) is no more than the equivalent of section 117(a)(4) of the 1939 Code which the Court in *Midland-Ross* held not a bar to treating original issue discount as ordinary income. The text of section 1232, in the initial 1954 Code, did not deal at all, as I read it, with the problem of original issue discount on bonds retained no more than half-a-year.

I agree with the taxpayer that the Congress which enacted that section may well have thought that original issue discount on such securities would thereafter be dealt with as short-term capital gain. But that was because that Congress mistakenly believed that *Commissioner v. Caulkins*, 144 F.2d 482 (C.A. 6, 1944)—which had held all original issue discount on bonds held for investment to be capital gain—would continue as good tax law except insofar as the rule was changed in section 1232 for the longer-term securities. And the probability is that that same Congress did not think it important to change the *Caulkins* rule for the no-more-than-six-months bonds because short-term capital gain is normally taxed at ordinary income rates. (The peculiar situation now before us does not seem to have been in any-

one's mind.)¹ At any rate, it seems to me clear that the Congress which enacted the 1954 Code did not adopt, in section 1232 or another provision, any rule for original issue discount on evidences of indebtedness held for no more than six months; it simply left that subject uncovered by specific rule. The result is that, since Congress has not imbedded any part of *Caulkins* in the Code, we are required to apply the rule of *Midland-Ross* which superseded and overruled *Caulkins*. Congress is not legislating when, instead of laying down a statutory rule, it leaves a subject alone, even though it may be content to let the matter be covered by a lower-court decision which later happens to be set aside by the Supreme Court. Cf. *Helvering v. Hallock*, 309 U.S. 106, 119-22 (1940).²

As for the claim of unlawful discrimination, I would rest squarely on the ground that the taxation of non-resident foreign taxpayers raises such different considerations that it cannot validly be compared, for equal protection purposes, to the taxation of domestic taxpayers.

1. There is no solid indication that the section 1232 Congress affirmatively desired that original issue discount on bonds held for no more than six months should be treated as capital gain even if *Caulkins* should be overturned by the Supreme Court.

2. The views of a later Congress on the earlier law have "very little, if any, significance." *United States v. Southwestern Cable Co.*, 392 U.S. 157, 170 (1968). Therefore weight should not be given to the 1969 Senate report which said that "In * * * [the case of pre-1969 corporate indebtedness and Government bonds], gain on the sale or exchange of a bond or other evidence of indebtedness which is a capital asset in the hands of the taxpayer but which has not been held by the taxpayer for more than 6 months is to be treated as a short-term capital gain as under present law." S. REP. NO. 91-552, 91st Cong., 1st Sess. 148 (1969) (1969-3 CUM. BULL. 518).